FILE COPY

No. 178

Supreme Court, U.S.
FILED
JUN 26 1935
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1934.

GREAT NORTHERN RAILWAY COMPANY,
Petitioner, and Appellant below,

vs.

J. J. WEEKS, State Tax Commissioner; J. M. BAILLIE as Auditor and L. T. HALVORSON as Treasurer of Barnes County, et al., all of the State of North Dakota,
Respondents, and Appellees below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

F. G. DORETY,
C. J. MURPHY,
Solicitors for Petitioner,
175 E. 4th St.,
St. Paul, Minn.

INDEX.

Petition.

Page.

Summary Statement of the Matter Involved..... 3

Reasons Relied on for the Allowance of the Writ..... 7

Brief.

The Opinions of the Courts Below 11

Jurisdiction 12

Statement of the Case 13

Admitted Excessiveness of the Assessment..... 13

Factors in the 1932 Assessment Making its Adoption for 1933 Unlawful 14

Proof that Mileage Prorates Were Actually Used in Making the Assessment 19

Proof that Mileage Prorates Actually Assessed Property in Other States 22

Specifications of Error 28

Argument 30

The Usual Rule, Requiring Proof of Some Specific Arbitrary Method, Should be Held Inapplicable to the Facts in this Case 30

There was Arbitrary Action in Disregarding Depression Economics 34

The Actual Use by the State of the Mileage Prorates as a Method of Allocation was Sufficiently Proven. 39

We Should not be Required to Negative the Use of Other Methods 40

Unlawfulness of the Mileage Prorates 44

Conclusion 50

CASES CITED.

	Page.
A. T. & S. F. Ry. Co. v. United States, 284 U. S. 248.	7, 34, 50
Chicago, Burlington & Quincy R. R. Co. v. Babcock, 204 U. S. 585	7, 43, 50
Fargo v. Hart, 193 U. S. 490	7, 44
In re Assessment of Kansas City Southern Ry. Co., 168 Okla. 495, 33 P. (2d) 772	7, 36
M. & O. R. R. Co. v. Schnipper, 31 F. (2d) 587, 589.	18
Northern Pacific Ry. Co. v. Adams County, 1 Fed. Supp. 163 at 170 and 171	33
Pennsylvania Railroad Co. v. Jacoby & Co., 242 U. S. 89	7, 40, 44, 50
Pittsburgh, C. C. & St. L. Ry. Co. v. Backus, 154 U. S. 421	45
Rowley v. C. & N. W. Ry. Co., 293 U. S. 102, 55 S. Ct. 55	45, 46
Southern Ry. Co. v. Kentucky, 274 U. S. 76	45
Union Tank Line Co. v. Wright, 249 U. S. 275	45, 49
Wallace v. Hines, 253 U. S. 66	7, 45, 46, 50

STATUTES CITED.

	Page.
U. S. Code, Title 28, Sec. 350	12
Judicial Code, Par. A, Sec. 240, as amended and re-enacted by Act of February 13, 1925 (U. S. Code, Title 28, Sec. 347)	12
Judicial Code, Section 41(1)	12
Judicial Code, Section 225(a)	12

Supreme Court of the United States

OCTOBER TERM, 1934.

GREAT NORTHERN RAILWAY COMPANY,
Petitioner and Appellant below,

vs.

J. J. WEEKS, STATE TAX COMMISSIONER; J. M. BAILLIE as Auditor and L. T. Halvorson as Treasurer of Barnes County; G. A. Gilbertson as Auditor, W. D. Conway as Treasurer and Bert M. Salisbury as Auditor-elect of Benson County; Ole Colbornson as Auditor, Sam H. Wilson as Treasurer, C. E. Hurst as Auditor-elect and Arlan Stair as Treasurer-elect of Bottineau County; H. F. Magedanz as Auditor, Jerry Donovan as Treasurer and Thomas P. Borgen as Treasurer-elect of Burke County; F. Ford Doherty as Auditor, C. A. Baumgartner as Treasurer and Paul H. Eddy as Treasurer-elect of Cass County; Otto Rasmusson as Auditor and A. A. Wilson as Treasurer of Cavalier County; John A. Dawe as Auditor, H. J. Oberman as Treasurer and Harry Bjornstad as Treasurer-elect of Dickey County; R. H. Lynch as Auditor, O. A. Steffler as Treasurer, Myrtle Skabo as Auditor-elect and Albert T. Heide as Treasurer-elect of Divide County; S. W. Lyman as Auditor, Hugh Peoples as Treasurer and S. K. Haugland as Auditor-elect of Eddy County; J. B. McWethy as Auditor, M. P. Roberts as Treasurer and Alice Cole as Treasurer-elect of Foster County; Martin O. Haugen as Auditor, John Sandbek as Treasurer and Albert Brenna as Treasurer-elect of Grand Forks County; P. A. Melgard as Auditor, R. J. Howden as Treasurer, R. J. Howden as Auditor-elect and H. B. Nelson as Treasurer-elect of Griggs County; E. W. Olson as Auditor and Oscar R. Fisher as Treasurer of McHenry County; Arne Tollefson as Auditor, Oluf Erickson as Treasurer and

O. M. Fritsvold as Treasurer-elect of McKenzie County; F. J. Haines as Auditor, Nels Hofland as Treasurer, M. L. Glarum as Auditor-elect and Sadie Hofland as Treasurer-elect of Mountrail County; Peter Jorgenson as Auditor and J. J. Schindele as Treasurer of Nelson County; Wm. W. Felson as Auditor, J. H. Hannesson as Treasurer and Norval W. Hodgson as Treasurer-elect of Pembina County; O. A. Spillum as Auditor and O. T. Tofsrud as Treasurer of Pierce County; J. O. Peterson as Auditor and F. J. Burckhard as Treasurer of Ramsey County; C. E. Colcord as Auditor, W. C. Budke as Treasurer, W. E. Coutts as Auditor-elect and Einar Johnson as Treasurer-elect of Renville County; George J. Fischer as Auditor, Karl L. Mikkelson as Treasurer and Einar Vohnson as Treasurer-elect of Richland County; Jas. H. Penny as Auditor, Allister McKay as Treasurer and E. M. Anderson as Treasurer-elect of Rolette County; R. W. Safstrom as Auditor and H. O. Webster as Treasurer of Sargent County; G. J. Mustad as Auditor, Florence Carlson as Treasurer and Ella B. Johnson as Treasurer-elect of Steele County; A. T. Mooney as Auditor and John Gang as Treasurer of Towner County; Gerhard D. Olson as Auditor and Thomas P. Strand as Treasurer of Traill County; W. J. LaMarre as Auditor and Benj. A. Gudajtes as Treasurer of Walsh County; A. G. Torgerson as Auditor and Bert A. Balerud as Treasurer of Ward County; Otto G. Krueger as Auditor and Edith Darcy as Treasurer of Wells County; Morten Mortenson as Auditor and Oscar N. Lee as Treasurer of Williams County, all of the State of North Dakota,

Respondents, and Appellees below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

TO THE HONORABLE CHARLES EVANS HUGHES, CHIEF JUSTICE, AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner shows:

I.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is an action in equity brought in the United States District Court for the District of North Dakota by the Great Northern Railway Company, petitioner herein, against 83 tax collecting officers of the state and of various counties of North Dakota, respondents herein, to contest an assessment of $78,832,888 by the State of North Dakota against the property of the petitioner Great Northern Railway Company for the year 1933 and to restrain the collection of a tax levy of $1,508,352.34. The trial was by the court and decree was rendered against petitioner, plaintiff below, and in favor of the respondents, defendants below. An appeal from said decree was taken by petitioner to the Circuit Court of Appeals for the Eighth Circuit, which affirmed the decree of the district court.

The assessment in North Dakota was almost twice as great, in proportion to the amount of physical plant, as in the seven other states along the Great Northern line, and North Dakota was the only one of the states which did not recognize the depression by substantially reducing its assessment in 1933. (Ex. 9, R. 80-81).

In contrast with the assessment of $78,832,888, plaintiff computed the actual vaue of the property at $23,937,317, or less than one-third of the assessment (Ex. 19, R. 111-113). Mr. Baker, the state's only witness and its ex-Deputy Tax Commissioner, computed the actual value at $63,307,629 according to what the state claimed to be the "best and most accurate

method" (Ex. P, R. 28, 189-190). Mr. Baker testified that after several months' study, he had been unable to make a computation of value equal to the assessment (R. 190). The state offered no explanation as to how the 1933 assessment was in fact determined and suggested no method by which so large an assessment could be computed for that year. The 1933 assessment per mile was identical with that for 1932, and plaintiff contended that the Board had simply adopted a valuation computed for the prior period (R. 26, 81).

Plaintiff contended that the state's valuations included some $20,000,000 worth of terminal property, mountain construction and other properties actually located in other states, which was unlawfully credited to North Dakota by the use of improper mileage prorates; and also that the Tax Board went beyond the permitted range of its discretion in ignoring the shrunken earning power and reduced values of the depression era, and that both the assessment and Mr. Baker's computation of value were based upon obsolete boom period values.

There was no dispute as to basic figures or as to the accuracy of mathematical computations. The pleadings admitted that for 1932 and prior years the Tax Board computed a system value and allocated it to North Dakota in proportion to track miles, ton and passenger miles, car and engine miles and other mileage factors (R. 7, 26). The evidence shows without dispute that the mileage factors used were all of unequal content and represented much less property and service in North Dakota than outside (See brief for references in the record). The mileage factors credited 18.34% of the entire property to North Dakota in 1932 while both sides agree that only 13.85% of the physical plant is located there and that it had less than average traffic density and use value (Exhibits N, J, K, 13, 14).

None of the assessments were absolutely identical in amount with the values computed by the mileage prorates but the assessments for 1930 and 1931 were within a small fraction of 1% of such values. In 1932 and 1933 the computed valuation fell rapidly while the assessments remained relatively stationary, so that for the later years, the computed values were substantially less than the assessments (Exhibit P).

The lower court held that neither the admission in the pleadings that the system value was allocated to the state in proportion to the mileage factors, nor the other evidence of such allocation, were sufficient to prove that the assessments were in fact based upon such allocations, because the assessments were not identical in amount with the mileage computations, and because the state alleged (without any proof) that the Board also considered other evidence and its own common knowledge. The court held that in addition to this proof that substantial effect was in fact given to mileage prorates which necessarily imported $20,000,000 worth of outside values into the state, we must assume the burden of negativing the use of any common knowledge or of any other possibly lawful method of computation which might sustain the assessments.

The most important issues upon the appeal were:

(1) As to the range of discretion permitted to a Tax Board in ignoring changed economic conditions and depression values.

(2) As to whether an admission by the state's expert witness of inability to justify the assessment by any customary method of computation coupled with a computation according to the "best and most accurate method" known to the state, showing the assessment to be more than $15,000,000 in excess of actual value, should not in itself and without other proof of an arbitrary or wrongful method, sufficiently satisfy the court that the assessment must have been arrived at arbitrarily.

(3) As to the necessity of negativing the use of other possibly lawful methods of computation, where the pleadings admit the use of mileage prorates, where the evidence shows that such mileage prorates would necessarily assess about $20,000,000 of values outside the state, and where the assessment approximates although it is not identical with the mileage computation.

(4) As to whether a Tax Board may compute a valuation which includes several million dollars worth of outside property, and then immunize the assessment against attack by adding or subtracting a few dollars based on the "common knowledge" of the Board.

(5) As to whether any unlawfulness proved to exist in the 1932 assessment is not carried over into 1933 by the adoption of the same identical amount for the 1933 assessment.

Judge Sanborn in his concurring opinion said:

> "* * * I have no doubt that the property of the appellant in North Dakota was overvalued for tax purposes in 1933 * * *. In this case the defendants' own expert states that no method of computation with which he is familiar would produce a value for 1933 equal to that fixed by the State Board. * * * I believe that if interstate commerce by rail continues to be unreasonably overburdened with the state taxes, either Congress or the courts will find some way to protect them."

Judge Sanborn nevertheless concurred in the decision, holding that the court was without power to afford relief.

II.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The reasons relied on for allowance of the writ are:

(a) We believe that the Circuit Court of Appeals departed from the principles of *Pennsylvania Railroad Co. v. Jacoby & Co.*, 242 U. S. 89, holding that where it sufficiently appears that an administrative tribunal must have based its result upon a wrongful method of computation, the attacking party is not required to negative the existence before the tribunal of other possibly lawful methods or evidence. Under this decision the admissions and proof that effect was given to an unlawful computation should have been sufficient without requiring plaintiff to negative the use of other evidence or methods; and the identity in amount of the 1933 assessment with that for 1932, coupled with proof that the 1932 assessment was inapplicable to the shrunken values of 1933, and that it was arrived at through the unlawful use of mileage prorates should have condemned the 1933 assessment.

(b) We believe that the Circuit Court of Appeals failed to give adequate weight to *Chicago, Burlington & Quincy R. R. Co. v. Babcock*, 204 U. S. 585, holding that assessing authorities have the immunity from examination of jurors or possibly of judges. To require the taxpayer to negative any consideration by the assessing officers of other methods of computation or of their own common knowledge, while preventing the taxpayer from calling the officers for examination, is to impose a requirement impossible to meet and to deny effective relief.

(c) We believe that the Circuit Court of Appeals violated the principles laid down by this court in *Fargo v. Hart*, 193 U. S. 490; and in *Wallace v. Hines*, 253 U. S. 66, holding that

a state which bases its assessment of railroad property upon the state's proportion of a predetermined system value, cannot lawfully use a basis of apportionment such as mileage, where the mileage is of unequal value, and where the apportionment necessarily assesses property located in other states.

(d) We believe that the decision of the lower court is inconsistent with *A. T. & S. F. Ry. Co. v. United States,* 284 U. S. 248, in which this court took judicial notice of the economic depression amounting to a changed economic level and held that failure of an administrative tribunal to give due recognition to this was not within the permitted range of its discretion. See also *In re Assessment of Kansas City Southern Ry. Co.,* 168 Okla. 495, 33 P. (2d) 772.

(e) The situation here is novel in that the state's only witness confessed that he could not justify the assessment by any known method of computation. The lower court, as stated by Judge Sanborn, felt "circumscribed" by the decisions of this court holding that arbitrary action or fraud must be shown. This court has never applied such a rule in a case where the excessiveness was confessed. We believe that the lower court has misapplied the decisions of this court, in requiring proof of the use of some specific unlawful method in this situation.

(f) As Judge Sanborn points out, "State taxation of interstate carriers is a matter of national concern", and "if interstate commerce by rail continues to be unreasonably overburdened with state taxes, either Congress or the courts will find some way to protect it." We submit that the assessment here is grossly unjust and inequitable and deeply prejudicial to interstate commerce and that the decisions of this court cited above afford ample grounds for relief.

WHEREFORE, your petitioner prays that a writ of certiorari under the seal of this court directed to the Circuit

Court of Appeals for the Eighth Circuit, commanding said court to certify and send to this court a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals had in the case numbered and entitled on its equity docket No. 10221, Great Northern Railway Company, Appellant, v. J. J. Weeks, State Tax Commissioner; J. M. Baillie as Auditor and L. T. Halvorson as Treasurer of Barnes County, et al., all of the State of North Dakota, Appellees, to the end that this cause may be reviewed and determined by the court as provided for by the statutes of the United States; and that the judgment herein of said Circuit Court of Appeals be reversed by this court, and for such further relief as to this court may seem proper.

Dated June 17, 1935.

GREAT NORTHERN RAILWAY COMPANY,
By F. G. DORETY,
C. J. MURPHY,
Solicitors for Petitioner.

Supreme Court of the United States

OCTOBER TERM, 1934.

GREAT NORTHERN RAILWAY COMPANY,
Petitioner, and Appellant below,

vs.

J. J. WEEKS, State Tax Commissioner; J. M. BAILLIE as Auditor and L. T. HALVORSON as Treasurer of Barnes County, et al., all of the State of North Dakota,
Respondents, and Appellees below.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

THE OPINIONS OF THE COURTS BELOW.

The opinion of the District Court of the United States for the District of North Dakota has not been officially reported but the decree is found at page 53 of the record.

The opinion of the United States Circuit Court of Appeals for the Eighth Circuit dated April 25, 1935, has not been officially reported to this date but will be found on pages 310-326 in the record.

II.

JURISDICTION.

The judgment of the Circuit Court of Appeals for the Eighth Circuit was entered on April 26, 1935 (R. 327), less than three months prior to the date of application for this writ of certiorari (U. S. Code, Title 28, Sec. 350).

The jurisdiction of the Supreme Court is invoked under paragraph A of Section 240 of the Judicial Code as amended and reenacted by the Act of February 13, 1925 (U. S. Code, Title 28, Sec. 347).

Federal jurisdiction exists under Section 41(1) of the Judicial Code covering diversity of citizenship. Plaintiff is a corporation organized under the laws of Minnesota and defendants are all citizens and residents of North Dakota. The amount or value in dispute excluding interest and costs exceeds the sum or value of $3,000.00 as to each of the defendants. Plaintiff alleged that the assessment and levy in question violate the constitution and laws of the United States in that they would take plaintiff's property without due process of law and impose an arbitrary and unreasonable burden on interstate commerce.

Appeal to the Circuit Court of Appeals was taken under Section 225(a) of the Judicial Code.

III.

STATEMENT OF THE CASE.

Admitted Excessiveness of the Assessment.

Paragraph IV of the Complaint (R. 4) sets forth the North Dakota statutes, which are admitted in the Answer, requiring the Board of Equalization to assess our property at its "true and full value in money". The amount of the contested assessment was $78,832,888 (Exhibit P). The amount was identical with the assessment for 1932 except for a deduction of $17,136 representing the value of a small amount of plaintiff's trackage in North Dakota which had been removed. The assessment per mile remained exactly the same as for 1932 (R. 26, 81).

Plaintiff's Exhibit 19 (R. 243) shows a computation of actual value at $23,937,317, or less than one-third of the assessment, based upon three years' average earnings capitalized at 7% and three years' stock and bond prices, allocated between states in proportion to net income (R. 111-113). The same system value allocated by the five factor mileage method advocated by the state would produce a North Dakota value of $37,306,238, or less than half of the assessment (Exhibit 19).

Defendants' Exhibit P in Schedule 4 shows a system value computed by Mr. Baker, the state's expert witness, from five years' earnings capitalized at 6% and five years' stock and bond prices, and allocated on the five factor mileage ratio, giving North Dakota a value of $63,307,629 for 1933, of which the assessment is 124.52%. The state's Answer alleges that this five factor ratio is the "best and most accurate" method of computation (R. 28). And the witness confirms the fact that it is Schedule 4 on Exhibit P which shows what the state claims

to be the fairest basis of allocation (R. 189). Mr. Baker also stated that he had been working on these exhibits for several months and that "in all that time I was not able to find any method of computation that would produce a value to North Dakota equal to the assessment for 1933 by any usually accepted method" (R. 190). This witness offered a large number of computations by various methods and exhausted the alphabet in lettering his exhibits, but nowhere in the record is there a computation equalling the assessment. The only explanation of the assessment for 1933, is its identity with that for 1932.

Factors in the 1932 Assessment Making Its Adoption for 1933 Unlawful.

The fact that the 1933 assessment was in the same amount as that for 1932, coupled with evidence showing how the 1932 assessment was computed, furnishes additional proof that the 1933 assessment was wholly arbitrary.

We have seen that the 1933 assessment was identical with the 1932 assessment except for a reduction of $17,136 representing the value of a small amount of trackage which had been removed. The assessment per mile remained the same as for 1933 (R. 8, 26, 81).

The 1932 assessment was based upon earnings and stock and bond values for the 5 preceding years, viz., 1927 to 1931, inclusive. Both the defendant's witness and the Answer show that a five year period immediately preceding the year of the assessment was always used for this purpose (R. 26, 148-150).

The following table shows the earnings (taken from Exhibit D) upon which the 1932 assessment must have been based.

1927	$29,202,540
1928	31,294,069
1929	32,457,523
1930	21,912,508
1931	12,669,420
5-year average	25,507,212

According to the same exhibit, the 1932 earnings, which were ignored in the assessment, had fallen to $1,290,551 or only 5% of the 5-year average.

It was the 5-year average of $25,507,212 for the years 1927 to 1931 from which the 1932 assessment was computed. And although the earnings for 1931 had fallen to $12,669,420 and for 1932 to $1,290,551, and although the latter figure was not reflected at all in the 1932 assessment, the 1932 assessment was nevertheless adopted for 1933 without any adjustment. It follows that the 1933 assessment was in fact based on average earnings of more than $25,000,000 when the earnings for the two years preceding had fallen to $12,000,000 and $1,000,000 respectively. It is really worse than this. Exhibit P shows that if the assessment had been reduced in 1932 to conform to the already reduced computed value, it should have been $75,605,688, while it was in fact $78,850,024. This was due to the fact that the reduction in assessment had lagged behind the fallen value. In other words, the 1932 assessment, which was adopted for 1933, still reflected a part of the 1931 computation which was based on earnings back to 1926.

The Circuit Court of Appeals held that the identity in amount between the 1933 and 1932 assessments does not prove that the 1933 assessment was arrived at by adopting that for 1932. But at least the figures serve to prove that in order to compute a value for 1933 equal to the 1933 assessment on the

basis of earnings, we would have to ignore the 1932 earnings and go back as far as 1926.

The same thing is true of stock and bond prices. The average stock and bond prices as shown by Exhibit B were as follows:

1927	$590,508,029
1928	606,649,827
1929	609,626,431
1930	571,[illegible]94,190
1931	461,845,051
5-year average	567,984,705

In 1932 the average stock and bond price had fallen to $296,301,177 or less than half of the peak figures (Ex. B).

We submit that the identity in amount of the 1933 assessment with that for 1932, which was based upon the above five-year average, shows that in 1933 the state ignored the 1932 figures entirely and went back as far as 1927 or even 1926 for its stock and bond prices. The figures at least demonstrate that in order to arrive at the 1933 assessment on the basis of stock and bond prices as well as of earnings, the state would have had to ignore 1932 figures and go back as far as 1927 or 1926.

This is even more arbitrary and unreasonable in the case of stock and bond prices than it is in the case of earnings. Current earnings reflect nothing but current conditions, and there is justification for considering past earnings as a measure of possible future earnings. But current stock and bond prices already reflect past prices and earnings as well as the hope for the future. They already reflect the full weight which in the judgment of investors, should be given to the higher prices of the preceding five years. To average them arithmetically

with the past prices is, therefore, to give double weight to the past prices.

Regardless of the unlawfulness of the mileage prorates, it would seem that an assessment which can only be supported by ignoring current earnings and stock and bond prices and those for the entire year preceding the assessment, and going back to prices of six and seven years before in what was virtually a different economic era, is so unreasonable as to be arbitrary per se.

Mr. P. B. Beidelman, the plaintiff's Freight Traffic Manager, pointed out that the plaintiff's gross revenues had fallen from $126,000,000 in 1928 and 1929 to $55,000,000 in 1932 and $62,000,000 in 1933 (R. 65). He made an elaborate analysis of the traffic, commodity by commodity, showing how much of this shrinkage was due to the general business depression and might be recovered under normal business conditions, and how much was due to permanent causes from which there could be no recovery, such as diversion to the Panama Canal, motor vehicles, pipe lines and other agencies of transportation, permanent changes in business conditions such as location of more and more industries on the Pacific Coast, changes in rate-making policies of the Interstate Commerce Commission and other causes. He concluded that there was no reasonable expectation of gross earnings in the future, after return to normal business conditions, of more than $86,000,000 annually (R. 70). Mr. V. P. Turnburke, the plaintiff's General Auditor, made an analysis of the present and probable future level of operating expenses as compared with the past and concluded that with a return of $86,000,000 in gross revenue, the Company's net railway operating income could not be over $14,000,000, as compared with the average five year earnings of $25,000,000 upon which Mr. Baker based his valuation (R. 122).

It might be added that the earnings in these computations were capitalized at 6%. This is admitted in paragraph H of the Answer (R. 27). The state concedes that the proper rate of capitalization "cannot well be less than investors are willing to accept in making an investment in the same class of risk under ordinary conditions" (R. 148).

During the year 1933 when the assessment was made and also during the year 1932 preceding the assessment, the average actual yield on the market price of all outstanding Great Northern bonds varied from 10.72% to 11.23% (Exhibit 17, R. 109, 242). This shows the rate of yield which was required, not for purchase of the entire property including the equity, but for investment in bonds of the company affording a lien prior to the stock. Ordinarily the rate for capitalization of entire earnings in a railway tax case should be above the average bond yield. *M. & O. R. R. Co. v. Schnipper,* 31 F. (2d) 587, 589. Nor is this a temporary rate for a day, a week or a month, but it was the average yield required by investors in bonds over a period of two years. The rate of 6% may have been a fair rate to apply in making the assessment for 1931, and possibly for 1932. But there is no evidence in the record that capital could have been obtained at any such rate in the year 1932 or 1933 for this class of enterprise. For this additional reason, it would seem to be wholly unreasonable and arbitrary to adopt the 1932 assessment for 1933 or to adopt an assessment for 1933 that could only have been computed by capitalizing boom period earnings at a rate 4% below what investors were actually demanding.

Proof that Mileage Prorates Were Actually Used in Making the Assessment.

The pleadings on which we rely in proving the actual use of mileage prorates in allocating system value to North Dakota are as follows:

Paragraph IX of the Complaint reads as follows: (the italics being supplied)

"The assessments of plaintiff's property in North Dakota for 1933 and for many years immediately preceding were the result in effect of assessing in North Dakota properties and values actually located in other states, and of over valuing plaintiff's railroad system. For the year 1932 and many preceding years, the assessing authorities of North Dakota determined a value for plaintiff's railroad system by capitalizing its average yearly net earnings or income for various past periods at various rates of percentage and by averaging the value thus obtained with the average value of plaintiff's stocks and bonds as determined by their average selling price for various preceding periods, certain amounts being deducted from said stock and bond value as representing the value of property and securities owned by plaintiff but not constituting a part of its railway system. *Said assessing authorities then allocated to North Dakota as the value of plaintiff's property in North Dakota* a portion of said system value equal to the average proportion which certain figures for North Dakota bore to the corresponding figures for plaintiff's entire railroad system. The figures used in determining said proportions were the following:

(1) Miles of all track.

(2) Amount of physical property as measured by cost of reproduction less depreciation.

(3) Cars and locomotives moved one mile.

(4) Tons of freight and passengers moved one mile.

(5) Gross earnings, the gross earnings in North Dakota being computed by adding to the revenues in North Dakota from intrastate traffic a proportion of the revenue from all interstate traffic passing into or through North Dakota equal to the proportion which the miles of track in North Dakota used for moving such traffic bore to the total miles of track used for moving such traffic."

Paragraph F of the Answer (R. 26) answering Paragraph IX denies the assessment of property in other states and denies overvaluing plaintiff's property but makes no denial of the use of the five factor allocation ratio.

The following table shows a comparison between the values computed by the five factor ratio, by Mr. Baker, the state's expert witness and ex-Depnty Tax Commissioner, and the actual assessments as shown in Exhibit P Schedule 4.

	Computed Value	Assessment	Per Cent of Assessment to Computed Value
1930	$83,448,252	$83,294,688	99.82
1931	82,659,839	82,999,997	100.41
1932	75,605,688	78,850,024	104.29
1933	63,307,629	78,832,888	124.52

It will be noted that the 1930 assessment was within 18/100 of 1% of the value computed by the mileage prorates, and that the 1931 assessment was within 59/100 of 1%. It will also be noted that the ratio of the assessment to the computed value for 1932 and 1933 is larger simply because the computed valuation decreased while the assessment remained relatively stationary.

That effect must have been given to the mileage prorates is also shown by the fact that the assessment could not have been reached in any other way. The highest system value computed by the state's expert and shown on Exhibit P for 1933 is the five year stock and bond value of $358,297,406. This is

the highest system value computed by any witness by any method. The highest composite system value shown for any year is the 1930 value of $460,989,128. The 1933 assessment for North Dakota is nearly 23% of the highest 1933 system value and more than 17% of even the 1930 system value.

It is shown both by the state's Exhibit N and by plaintiff's Exhibit 19, line 4(e) that as of December 31, 1932, not over 13.85% (as measured by cost of reproduction less depreciation) of the physical plant was located in North Dakota. It is shown both by the state's exhibits J and K and by plaintiff's exhibits 13 and 14 that the traffic density in North Dakota was less than the average for the system, so that North Dakota's proportion of the system use value was no greater than its proportion of the system physical property. There is, therefore, no possible method of allocation by which the North Dakota value can be found to exceed 13.85% of the system value, and no possible method by which the assessment could have been reached, except by the use of mileage prorates.

Mr. Baker, ex-Deputy Tax Commissioner of North Dakota, stated with reference to the five allocation factors in question, "* * * Those five, in substance, are approximately what we have used in North Dakota to a greater or less extent for a number of years; the only difference I believe is that we have used car and locomotive mileage and not car mileage" (R. 151). On page 188 he says, "These formulas which I have presented (in Exhibit P) together with the various combinations of factors were at various times presented to the Board of Equalization by the Tax Commissioner, and the railroads did the same sort of thing". On page 170, he says, "All of the factors that I have used in this exhibit are factors in common use by taxing authorities and railroads in connection with assigning values for tax purposes, except the factor which I have

termed trackage owned and operated and trackage leased and operated". On page 171, he says, "I believe that tax officials and railroad tax men always make composite allocations based upon an average of the result of several of these factors".

The pleadings and evidence, therefore, establish the fact that allocations of system value were in fact made by the five factor ratio, that no methods of allocation except mileage prorates were in use, that the assessments were almost identical with the result of the mileage computations, except as they lagged behind when computed values were falling, and that there is no other known method by which so large a North Dakota value could be obtained from the highest claimed system value.

Proof that Mileage Prorates Actually Assessed Property in Other States.

The map (Exhibit 2) shows North Dakota as a gridiron of branch lines. Exhibit 6 shows that 61.7% of the mileage in North Dakota is branch line mileage, while the percentage on the balance of the system is only 43.5%. Exhibits 4 and 7 show that the three largest terminals are outside the state and are almost equal in value to the entire property in North Dakota (R. 75-77). Exhibit 5 shows that, of the smaller terminals, there are fewer per mile in North Dakota and that those in North Dakota are slightly smaller than the average (R. 76).

Exhibit 3 shows that the average mile of track in North Dakota has only 80.5% as much rail, 59.5% as much grading, about half as much bridging, and 63.9% as much signal installation as the balance of the system and practically no snow-sheds or tunnels (R. 74-75). Exhibit 7 shows that the average mile on the balance of the system contains 198% as much

total physical property as the average mile in North Dakota (R. 77).

In considering miles of movement such as car miles, ton miles, etc., we must remember that railroad service includes three elements: (1) providing the plant and equipment (2) keeping it in repair and (3) moving the traffic. The factor showing miles of movement reflects only the third element out of the total service. It follows from the statements in the last paragraph that for every mile of movement outside the state, the company has to provide twice as much plant and also to repair twice as much plant. In this respect an average mile of movement outside the state includes more total service than an inside mile.

An average car mile in switching service in the large terminals which are located in other states requires about 15 times as much effort and costs about 15 times as much in operating expenses as the average car mile on the road (R. 114-117). In using a car mile ratio, ten or fifteen cents worth of transportation service in North Dakota is assumed to be an equivalent unit with $3.00 worth of transportation service in the Minnesota and Washington terminals, simply because both are spread over a mile of ground (R. 114).

An average carloading in North Dakota is around 16 tons while the average carloading on the balance of the system is nearly 30 tons (R. 116, 130, 135). This is due to the large amount of less than carload tonnage moving in lightly loaded cars on North Dakota branch lines (R. 135).

While a locomotive on the iron ore carrying lines of the Great Northern in Minnesota hauls 170 cars or twelve or thirteen thousand tons per locomotive mile, a locomotive on the branch lines in North Dakota would haul about two to four hundred tons on the average. These particular engine

miles in North Dakota have an actual value in volume of traffic handled equal to only 1/70 of those on the Minnesota ore lines (R. 116). The state's tax expert conceded that car and engine miles moving smaller tonnage should not be given as much credit as car and engine miles with heavier tonnage (R. 201).

Exhibit 12 Schedule B, Line 7 (R. 239) shows that the movement of a thousand tons of freight one mile in North Dakota requires $7.19 worth of effort while the average movement of a thousand tons on the balance of the system requires $9.89 worth of effort. The ratio is nearly 10 to 7. As the average carload in North Dakota is 16 tons and the average carload on the rest of the system is 30 tons, it is easy to compute that the movement of an average car one mile in North Dakota requires 11½¢ worth of effort while the movement of an average car one mile on the balance of the system requires 29.68¢ worth of effort.

Still another vice of all of the ratios reflecting miles of movement is that they ignore mileage made in switching service in the terminals and consider only the miles made in roadhaul between terminals (R. 78, 115). If there should be five or six miles of switching service after the car reaches a terminal, each of these miles costing as much as 15 roadhaul miles, the effect would be the same as if we excluded 75 to 90 miles of roadhaul service outside the state on each trip while including the entire mileage made in North Dakota.

One of the factors used by the state in the five factor ratio is a gross revenue factor. But in computing gross revenues earned in North Dakota, interstate revenues are allocated in proportion to miles of road only (R. 87). 92% of all the traffic in North Dakota is interstate (R. 70). Approximately one-third of the service in an average through haul (as measured by cost) is performed in the terminal and two-thirds on

the road (R. 117). The miles made in terminals are given no weight whatever in computing the ratio, although they should be entitled to about fifteen times as much weight as road miles (R. 79, 115). It follows that a prorate of interstate revenue in proportion to miles of road is virtually a repetition of the track mile ratio and accords an excess of credit to a state like North Dakota.

Practically no rates are based on an absolute mileage basis (R. 125). There are no rules in the freight tariffs or accounting practices providing for mileage prorate of revenues as between states, and there is no public authority for allocating revenues on a mileage basis (R. 95).

The physical property ratio is the only ratio in the five factor formula which does not reflect mileage. There would be no serious objection to this factor if used alone, but when combined with four other factors all reflecting mileage, the result is greatly distorted. And the composite gives four times as much weight to mileage as to physical property (R. 66). The average of the five factors is 18.34% for 1933, while the physical property ratio alone at the end of 1932 was 13.84% (Exhibit N).

It follows that in measuring both property and service in North Dakota and on the balance of the system, the state used units of measurement which were alike only in length, and that the miles used for measurement in North Dakota were very much smaller in volume and the result was like comparing two bins of potatoes by measuring one with a half bushel basket and the other with a full bushel basket.

The record shows some illustrations of what absurd results can be produced by this sort of a comparison. For example, the Great Northern iron ore line lies 90 miles in Minnesota and 10 miles in Wisconsin, but the 10 miles in Wisconsin in-

clude the docks, repair shops and terminals and contain as much physical plant measured by cost as the 90 miles in Minnesota. The property in each state cost about $16,000,000, making a total of $32,000,000. And yet 90% of all track miles, car and engine miles, ton miles and gross revenue (on a mileage prorate) are credited to Minnesota, so that on the North Dakota formula, the aggregate value of $32,000,000 would be divided in such a way as to produce a $29,000,000 assessment for the $16,000,000 worth of property in Minnesota and a $3,000,000 assessment for the $16,000,000 worth of property in Wisconsin. The fallacy, of course, lies in overlooking the fact that in this particular case, the average mile of track and the average mile of movement in Wisconsin contain about nine times as much volume as the average mile in Minnesota (R. 96, 114, 139, 140).

If a road had a ten mile tunnel in one state and ninety miles of line in an adjoining state, each costing the same amount, the five factor formula would credit the latter state with 90% of the combined value and the former state with only 10%, although the property in each had the same cost. On the other hand, if the road in the first state were built 90 miles around the mountain instead of 10 miles through it and at the same cost, this state would get 50% of the combined value instead of only 10%, although its property would have no greater cost and perform no more service. The state's tax expert concedes that in such cases the five factor formula would not produce correct results (R. 197-8). There are actual situations on the Great Northern Railway where the North Dakota formula produces this same kind of a distortion except in a lesser degree (R. 77, 117-118).

Not only does the average mile of track in North Dakota contain only half as much plant, but, the plant carries less

traffic density than the average for the system. It is shown both by the state's exhibits J and K and by plaintiff's exhibits 13 and 14 that the traffic density in North Dakota is less than the average of the system. It follows that with only 13.84% of the physical property being located in North Dakota and with that property having a lower than average traffic and use value, the state, by the use of the five factor ratio, has assessed 18.34% of the entire property. She has assessed the 13.85% within her own borders and an additional 4.5% located in other states.

It is possible to allocate interstate revenues between the states in proportion to the cost of plant and cost of service contributed by each state toward the earning of the revenue. The plaintiff made such an allocation on Schedule B of Exhibit 12. It then added to North Dakota's share of the interstate revenue, her entire revenue from intrastate traffic and deducted the total expenses incurred in North Dakota, thus determining the amount of net income earned within the state. Exhibit 12 shows that over a five year period, 12.22% of the system net income was earned in North Dakota. If the system value be prorated in proportion to net earnings or earning capacity, only 12.22% should be allocated to North Dakota (R. 87-96). This confirms the fact that since only 13.85% of the physical plant is located in the state, and that portion has slightly less traffic value than the average, the allocation of system value to North Dakota should be something less than 13.84%. It again follows that in assessing 18.34% of the system value, North Dakota has assessed many millions of dollars worth of property outside the state. On the 1932 system value of $415,278,961 computed in Exhibit P, nearly $20,000,000 worth of property outside the state was allocated to North Dakota by the five factor ratio.

Of course, the actual assessment in many cases was higher than even the five factor formula would produce, due to the fact that assessments were not reduced as computed values fell. Exhibit 21 shows that the actual assessment in North Dakota during the years 1928 to 1932, inclusive, was from 46.4% to 94% in excess of the proportion of system value which could properly have been allocated to North Dakota on the basis of earning capacity.

IV.

SPECIFICATIONS OF ERROR.

(1) The Circuit Court of Appeals erred in failing to find that the assessment was more than double the actual value of the property and in failing to set aside the assessment on that ground.

(2) The Circuit Court of Appeals erred in permitting a range of discretion to the Tax Board sufficient to allow it to substantially ignore depression values and reduced economic levels and to base its assessment upon boom period values.

(3) The Circuit Court of Appeals erred in holding that plaintiff, in addition to proving the use of mileage prorates, must negative the use of any other possibly lawful method.

(4) The Circuit Court of Appeals erred in failing to find that the use of a wrongful method or arbitrary action was sufficiently established by the plaintiff's evidence of excessiveness plus the unsuccessful attempt of the state to justify the assessment; by the confession of the state's only witness that the assessment was 25% in excess of value computed by the "best and most accurate method", and that he knew of no method by which it could be justified.

(5) The Circuit Court of Appeals erred in holding that there is no basis for finding that property without the state has been assessed, unless the Board of Equalization adopted the "exact result" of a computation which included such outside values.

(6) The Circuit Court of Appeals erred in holding that there was no evidence of any deliberately arbitrary or wrongful assessment concerning years prior to 1933.

(7) The Circuit Court of Appeals erred in holding that any unlawfulness in the 1932 assessment was not necessarily carried over when the same assessment was adopted for 1933.

(8) The Circuit Court of Appeals erred in holding that it was not sufficiently established by the pleadings and evidence, that mileage prorates were in fact used in making the assessment, and that the Board of Equalization was guided or largely influenced by such computations.

(9) The Circuit Court of Appeals erred in holding that the proof of unlawfulness in the mileage prorate method of assessment depended upon proof that the only approximately true method of allocation was one based on "expense of operation".

(10) The Circuit Court of Appeals erred in holding that there is any evidence in this case that a 4% rate for capitalizing earnings would have been justified in 1933 and in failing to hold that 7% was not the minimum rate permissible under the evidence.

(11) The Circuit Court of Appeals erred in failing to find that the State of North Dakota by the use of mileage prorates had assessed many millions of dollars worth of property located in other states.

(12) The Circuit Court of Appeals erred in affirming the decision of the District Court and in entering judgment against the petitioner and in favor of the respondents.

(13) The Circuit Court of Appeals erred in not entering judgment in favor of the plaintiff as prayed for in the complaint.

V.

ARGUMENT.

The Usual Rule, Requiring Proof of Some Specific Arbitrary Method, Should Be Held Inapplicable to the Facts in this Case.

Where a taxpayer merely offers evidence of a value lower than the assessment, with no evidence of arbitrary action or fraud, the state is entitled to rest upon the presumption of lawfulness and is not obliged to support the assessment by evidence of its own. But where the showing of the taxpayer is so strong that the state feels compelled to defend the assessment, or where for any reason it attempts such a defense, and fails to produce any evidence whatever sufficient to support its assessment, but produces many computations of value all falling short, we submit that the conclusion is not only fair but inescapable, that the state had no proper basis for the assessment and that it must have been arrived at arbitrarily. As pointed out by the Circuit Court of Appeals, failure to testify cannot be used against the state, but where the state waives its privilege and chooses to justify the assessment and confesses that it is unable to do so, especially after such an elaborate attempt by an ex-Commissioner as was made here, it

is tantamount to confessing that the assessment was not based on any evidence or process of reasoning but that it was a purely arbitrary determination.

We have not been able to find any decision where there was such an implied confession as this and where the taxpayer was nevertheless required to specify the method used and to prove that it was arbitrary. Indeed, if it be a fact that the assessment was purely arbitrary—if no method whatever was used—it would be quite impossible for the taxpayer to specify any method or to prove that it was unlawful. Here the state's expert witness confessed that after months of study, he had been unable to find any method of computing value equal to the assessment. Evidence offered on both side proves that the value was far below the assessment. There is strong evidence that the actual value was only 1/2 or 1/3, and it requires no Sherlock Holmes to deduce from the evidence that the Board made no assessment upon 1933 data, but simply adopted an assessment made for a previous year which necessarily omitted any consideration of the shrunken earnings and stock and bond prices, and which was based largely upon data from an obsolete boom period.

As indicating the reluctance with which the Circuit Court of Appeals required proof of an arbitrary method, in addition to proof of the excessiveness, we quote the short concurring opinion of Judge Sanborn which was as follows:

> "The power of the Federal Courts to enjoin the collection of State taxes upon the property of an interstate carrier has been so circumscribed, as pointed out by Judge Stone in his able opinion, that, although I have no doubt that the property of the appellant in North Dakota was over-valued for tax purposes in 1933, I concur in the conclusion reached in the opinion and the reasons assigned for it. I am not, however, in entire sympathy with the

rule which seems to preclude any interference with such overassessments unless it clearly appears that they result from purely arbitrary action or from something akin to fraud. While death from an honest error of judgment may be preferable to death designedly caused, the effect upon the victim is the same. Overtaxation resulting from honest mistake or errors of judgment is as serious as that resulting from fraud, and constitutes just as unreasonable a burden upon interstate commerce. I regard state taxation of interstate carriers as a matter of national concern.

In this case the defendants' own expert states that no method of computation with which he is familiar would produce a value for 1933 equal to that fixed by the State Board. To that extent we have a different situation here than in the Rowley case. That the value of the portion of appellant's system in North Dakota in 1933, after the appellant had been through three years of depression, even approximated the values of 1928 and 1929 is to my mind inconceivable. Possibly I am substituting my judgment for that of the Board, but the Supreme Court in Atchison, Topeka & Santa Fe Railway Co., et al. v. United States, et al., 284 U. S. 248, referred to a record made in a rate hearing in 1928 as pertaining to a 'different economic era', and said (page 262):

> 'This is not the usual case of possible fluctuating conditions, but of a changed economic level.'

Certainly no group of men who in 1933 were ready, able and willing to buy the appellant's system and who were clothed in their right minds, would have paid, as the result of fair negotiations, any such sum for the portion of the road in North Dakota as was fixed by the Board. So that, while I agree that the court below, upon this record, was justified in denying the injunction prayed for, I am suffering from no illusions with respect to the great changes which took place in the value of all railway properties between the years 1929 and 1933. It may be im-

possible now for the Federal Courts to grant any relief to interstate carriers from overtaxation possibly resulting from honest mistakes or errors of judgment on the part of the taxing authorities of those States through which their lines run, but I believe that if interstate commerce by rail continues to be unreasonably overburdened with state taxes, either Congress or the courts will find some way to protect it. In this connection, the opinions of Judge Webster in Northern Pacific Ry. Co. v. Adams' County, et al., (D. C. E. D. Wash.), 1 F. Supp. 163, and of Mr. Justice Brandeis in Nashville, Chattanooga & St. Louis Ry v. Walters, et al., ... U. S. ...., 55 S. Ct. 486", opinion filed March 4, 1935, are of interest.

We believe that a sounder line of reasoning is found in the language of Judge Webster in *Northern Pacific Ry. Co. v. Adams County,* in 1 Fed. Supp. 163, at pages 170 and 171, where the court said:

"There is no direct evidence in the record showing the methods which were employed by the tax commission in making the offending assessments. No member of the commission took the stand to explain the basis or bases upon which the commission acted in valuing and assessing the properties. No record of the commission shedding light on the method used was produced in evidence. It requires no argument to demonstrate that this attitude on the part of the commission does not foreclose all inquiry into the legality of their determinations. It merely serves to make necessary a different and obviously more difficult method of approach. In order to determine whether their valuations were properly made or are tinctured with constructive fraud arising out of gross excessiveness, it becomes necessary to consider whether, under any legally permissible method or combination of methods recognized by law for ascertaining value, their action can be upheld as within the proper and legitimate exercise of their powers and discretion. This will be the standard of measure-

ment which I shall apply in reaching my conclusions in this regard.

* * * * * *

Inasmuch as the Legislature of Washington has not defined specifically how railroad property shall be valued for taxation, I am of the opinion that the proper way of testing whether the action of the state tax commission can be upheld is to inquire whether under any legally authorized method or methods its determinations can be justified and sustained."

In the case just quoted from, the amount of overassessment which was alleged (p. 168) was much less than the excess which we believe we have proven in this case, and yet the court found there that the assessments were "so grossly excessive as to give rise to a presumption of constructive fraud" (p. 185).

There Was Arbitrary Action in Disregarding Depression Economics.

Our 1929 assessment at the culmination of the boom period was $83,294,677. It was reduced about $4,000,000 in 1932 and the 1933 assessment was only 5% below that for 1929 (Exhibit P). Assessments for previous years are shown on Exhibit Q. The customary bases for determining system value, such as earnings and stock and bond prices, whether for periods of one year, three years, or five years preceding the assessment, had decreased from 21.89% to 89.81%, between the assessment dates of 1932 and 1933. The average decrease was 50.52% (Ex. 20, R. 119).

That a failure to give adequate recognition to changed economic conditions is not within the permissible discretion of an administrative tribunal, is the effect of the decision in *A. T.*

& S. F. Ry. Co. v. United States, 284 U. S. 248. At page 260 this court said:

> "There can be no question as to the change in conditions upon which the new hearing was asked. Of that change we may take judicial notice. It is the outstanding contemporary fact, dominating thought and action throughout the country. As the Interstate Commerce Commission said in its recent report to the Congress, 'a depression such as the country is now passing through is a new experience to the present generation'. The Commission also recognized in that report 'the very large reductions in railroad earnings which have accompanied the economic depression', and stated that 'the chief cause of these reductions has been loss of traffic'. For 'in such depressions the railroads suffer severely. Their traffic is a barometer of general business conditions'."

Referring to suggestions regarding the wide discretion of the Commission, the court said on pages 261 and 262:

> "These suggestions would be appropriate in relation to ordinary applications for rehearing, but are without force when overruling economic forces have made the record before the Commission irresponsive to present conditions."

The following language on page 262 seems equally applicable to a tax board:

> "We are thus brought to the fundamental considerations governing the authority of the Commission. It has broad powers and a wide extent of administrative discretion, with the exercise of which, upon evidence, and within its statutory limits, the courts do not interfere. The important and salutary functions of the Commission to enforce public rights are not to be denied or impaired. But the Commission, exercising a delegated regulatory authority which does not have the freedom of ownership, operates in a field limited by constitutional rights and legislative requirements."

Following this the court held that failure to recognize changed economic conditions "was not within the permitted range of the Commission's discretion."

It would seem to follow that an assessment for 1933 which can only be justified by ignoring earnings and stock and bond prices of 1932 and 1933 and going back to the boom years of 1926 to 1929 is not within the permitted discretion of a Tax Board.

In the case of *In re Assessment of Kansas City Southern Ry. Co.*, 168 Okla. 495, 33 P. (2d) 772, the court held that an assessment for 1933 based upon earnings and stock and bond prices for the five years immediately preceding the assessment were so arbitrary that it must be cancelled, upon the ground that the five year period included boom year earnings of an obsolete economic era which no longer afforded a logical measure of probable future earnings. The court said (p. 786 Pac. Rep.):

> "The court takes judicial knowledge that there has been an era of depression, nation and world wide. This has had its destructive influences on railroad property as well as other property.
>
> * * * * *
>
> "We do not think it tenable that those two years, 1928 and 1929, should be used in reflecting an assessed valuation of the railway property in 1933.
>
> * * * * *
>
> We have been passing through an entirely different economic and industrial era since the years 1928 and 1929. Panicky conditions have prevailed. The organic condition of the railroad, its ties, rails, equipment, etc., are perhaps substantially the same, usual wear and tear excepted, but the figures conclusively prove that there has been a loss of earning power occasioned by other competing transport agencies, bus lines, truck lines, and air

lines. The railway company asserts with confidence that this loss of business will not return to the railway company.

In the light of these facts, we are of the opinion that the taxable value of the railway company as of February 1, 1933, cannot be determined by measuring the peak of prosperity in the years 1928 and 1929 with the income derived during the commercial disaster of the business, in the years 1930, 1931 and 1932, and that the years 1930, 1931 and 1932 constitute a measurably substantial period of time for the purpose of sufficiently reflecting the proper assessable value of the property in question fixed as of February 1, 1933."

Our case is stronger than the Kansas City Southern case because there the Board had actually attempted to exercise its functions in 1933 and had based its computation upon the five preceding years including 1932 while here the assessment can only be computed by eliminating 1932 entirely and going back as far as six years before the assessment.

Mr. Baker computed his valuation of $63,307,629 for the North Dakota property (which was 25% below the assessment) from earnings and stock and bond prices of the five years 1928 to 1932, inclusive, including the boom years of 1928 and 1929, capitalizing the earnings at 6% and allocating the system value to North Dakota by mileage ratios (Exhibit P). The valuation of $23,937,317 (Exhibit 19) is obtained from earnings and stock and bond prices of the three years 1930 to 1932, capitalizing the earnings at 7% and allocating the system value in proportion to earning capacity.

We submit that whatever value there may be in stock and bond prices lies in the current figures. If the average value of Great Northern stock for the past three years has been 15, the fact that it sold at 125 five years ago throws little light on the

judgment of investors as to the present value of the property. Past prices are already given all the weight that they are entitled to on the present market. If in Exhibit 19 we had capitalized earnings for five years instead of three years, and retained the three years' stock and bond prices, the North Dakota valuation would have been increased to about $31,000,000.

If the system value of $345,188,820 computed by Mr. Baker in Exhibit P from the five year figures were allocated in proportion to earning capacity, his North Dakota value would be only about half of the assessment. In order to reach Mr. Baker's computation of $63,307,629 (which is 25% below the assessment), we must assume first that stock and bond prices as well as earnings of a period five years before the assessment are entitled to the same weight as current prices and earnings in determining system value, and second that North Dakota can assess 18.34% of that system value although only 13.85% of the property is within her borders. If any substantial weight be given to current stock and bond prices and to the fact that the current yield on investment in Great Northern bonds was more than 10%, or if any correction be made for the excess in mileage prorates, either correction would enforce the conclusion that the assessment was at least double the actual value of the property.

Based upon the maximum gross earnings of $86,000,000 a year to be expected in the future as estimated by Mr. Beidelman, and the net earnings from this revenue of $14,000,000 as estimated by Mr. Turnburke, the system value, even with a 6% rate of capitalization, would be less than $235,000,000, and North Dakota's share, even on the mileage prorate, would be less than $45,000,000.

The Actual Use by the State of the Mileage Prorates as a Method of Allocation was Sufficiently Proven.

Assuming that in spite of the confessed excess in the amount of the assessment, and the failure to recognize depression values, we are still required to prove a specific method by which the assessment was arrived at, and that it was unlawful, we submit that we have met this requirement.

Mr. Baker testified that the mileage ratios had been used for a number of years. All of the computations of value in his numerous exhibits are based on mileage prorates. He was Deputy Tax Commissioner for 13 years (R. 144). His entire testimony is in advocacy of mileage prorates. In an elaborate description of all methods of taxation known to him, he mentioned no other method of allocation. The allegation of the Complaint is not denied that for many years the assessing authorities allocated system value to North Dakota on the five factor ratio. And in 1930 and 1931 the assessments were within a fraction of 1% of the amounts so computed. The Board had these computations before them; they had no other computations based on any other method of allocation; the assessment closely approximated the computation; and there is no other possible method by which so large an assessment for North Dakota could be determined from even the highest estimate of system value shown in the record. North Dakota contains only 13.85% of the total plant, and that 13.85% had less than average use value. 13.85% of $345,188,820, which is the highest system value computed by anyone for 1933 (Exhibit P), would produce an assessment of only $48,000,000 as compared with the actual assessment of nearly $79,000,000.

No slight variation between the assessment and the unlawful computation can cure this. To include in the computation

$20,000,000 worth of outside property and then to subtract or add half a million does not right the wrong. It is the giving of substantial effect to the unlawful formula and not the rigid adherence to every detail of it that forms the basis of our action.

If the assessment in 1931 had been $82,659,839 (the exact amount of the mileage computation) instead of $82,999,997 as it was (a difference of $340,158.00) we take it that the Circuit Court of Appeals would have been compelled to admit that the assessment was arrived at by the use of mileage prorates and that it contained approximately $20,000,000 worth of values outside the state. Because $340,000 was deducted, the court seems to have assumed that the $20,000,000 error was cured and that the court was without power to afford relief. It seems contrary to sound judgment for a court to so emasculate its powers by deliberately tieing its own hands with technicalities which seem so unrelated to reason and logic.

And if the out-state values were in the 1931 and 1932 assessments, they still remained there when the 1932 assessment was adopted for 1933, even though the computation was not repeated for that year. The controlling question must be whether the assessment includes substantial out-state values.

We Should Not Be Required to Negative the Use of Other Methods.

The Circuit Court of Appeals held that in addition to this proof that substantial effect was in fact given to the mileage prorates, we must go further and negative any use of any possibly lawful method of computation which might sustain the assessment.

We submit that this violates the spirit and principle of the decision of this court in *Pennsylvania Railroad Co. v. Jacoby*

& Co., 242 U. S. 89. In that case the railroad company was attacking a reparation award of the Interstate Commerce Commission which, like the assessment in question here, was presumed to be lawful. The proof consisted simply in showing that the amount of the award was identical with the amount of a computation contained in a certain Exhibit 10, which had been introduced before the Commission by one of the parties, and which the court held would be an unlawful method of computation.

In that case the railroad company had not produced in court the entire record made before the Commission. It appeared that the Commission had had before it, evidence other than that which was produced in court, and the railway company failed to negative the possibility that some of the other evidence might have been sufficient to justify the award by some lawful method of computation. For this reason, the plaintiff took the position, which the Circuit Court of Appeals took in our case, and urged that under the presumption of lawfulness, the railway company's attack upon the award was inadequately supported. This court said on page 99:

> "It is urged that the testimony before the Commission is not all in the record, and that for aught that appears the Commission may have reached its conclusion and awarded damages upon other and competent proofs, and it is insisted that the coincidence of the amount as awarded and the amount ascertained by the use of the percentages contained in the tables may not necessarily have controlled the action of the Commission. But it is difficult to reach the conclusion that the Commission could have arrived at the result so exactly corresponding with the one obtained by the use of the percentages shown in the tables, except by actually using them to ascertain the sum which is exactly the amount resulting from their application. The Commission might have approximated the

> same result by using other and legal means to ascertain the damages sustained, but when it is demonstrated that the use of the percentages precisely produces the amount awarded to the dollar and cent, it seems almost mathematically certain that the result could have been reached in no other way. At least, we think that the testimony was in such shape that, as we have already said, the Company was entitled to the specific request upon this subject submitting the matter to the jury."

We might paraphrase the second sentence of the above quotation by saying:

> "But it is difficult to reach the conclusion that the Board of Equalization could have arrived at a result so closely corresponding with the one obtained by the use of the mileage prorates, except by actually using the mileage prorates to ascertain the assessment which so closely approximates the amount resulting from their application."

In many ways our case is stronger than the Pennsylvania Railroad case. There the unlawful computation had been introduced by a litigant and not at the request of the Commission. Except for the identity in amount, there was no evidence that the Commission had placed any reliance upon it. Here the unlawful computation was one procured by the Board itself, not only for the current year but for several preceding years, and there is no suggestion of any other method of computation which was ever considered. While the amounts are not identical, this is explained by the obvious fact that the assessment for each year was related to that for the preceding year. The assessment was clearly the result of the mileage computation, with some modification to avoid too great variation from preceding assessments. In addition we have positive proof here that no system value could have been com-

puted, high enough to support the North Dakota assessments except by a mileage allocation.

We submit that there is even greater reason in a case against a tax board than in a case against the Interstate Commerce Commission for a court of equity to relax the rigorous requirement that the existence of other wrongful evidence must be negatived, and for shifting the burden of proof to the administrative board under such a showing as this. The Board of Equalization of North Dakota is not required to hold hearings nor to make a record of evidence considered by it. And in *C. B. & Q. R. R. Co. v. Babcock*, 204 U. S. 585 at 593, this court held that the members of such a board have the immunity of a juror if not of a judge in the matter of being examined in regard to the findings. It follows from this as a practical matter that if the opinion of the lower court is to stand, the Tax Board is free to compute its assessment by an unlawful formula, add or subtract a few dollars so as to destroy the "identity" and rely upon an allegation and a presumption that other evidence and common knowledge were considered, to cure the illegality. The burden of negativing this as a practical matter is an impossible one. The effect is to leave the taxpayer subject to extortion and confiscation and to deny him any relief in equity.

It is so easy for the Board to show what evidence and what knowledge it had and so difficult if not impossible for the taxpayer to show it that there would seem to be even more justification in a tax case than in a case against the Interstate Commerce Commission for a court of equity to relieve a taxpayer of this crushing burden of proof when the evidence fairly convinces the court that a wrongful method has been used and that wrong has been done.

As to our contention that the 1933 assessment was determined merely by adopting the 1932 assessment with a slight correction for trackage removed, *Pennsylvania Railroad Co. v. Jacoby & Co.*, supra, seems to support this contention exactly, because here we have the exact identity in amount which was shown in that case.

Unlawfulness of the Mileage Prorates.

Assuming it to be sufficiently shown that the assessment reflected the use of mileage prorates, and based upon the undisputed proof that the mileage factors used were all of substantially smaller volume in North Dakota, the unlawfulness is established by many decisions of this court.

In *Fargo v. Hart*, 193 U. S. 490, this court said:

> "It is obvious, however, that this notion of organic unity may be made a means of unlawfully taxing the privilege, or property outside the state, under the name of enhanced value or good will, if it is not closely confined to its true meaning. So long as it fairly may be assumed that the different parts of a line are about equal in value, a division by mileage is justifiable. But it is recognized in the cases that if, for instance, a railroad company had terminals in one state equal in value to all the rest of the line through another, the latter state could not make use of the unity of the road to equalize the value of every mile. That would be taxing property outside of the state under a pretense."

The last two sentences are peculiarly applicable to the facts in our case because it is shown here that three of our outside terminals were in fact substantially equal in value to the entire property in North Dakota.

In *Wallace v. Hines*, 253 U. S. 66 at 69, the court said:

> "As the law is administered, the tax commissioner fixes the value of the total property of each railroad by the total value of its stocks and bonds and assesses the proportion of this value that the main track mileage in North Dakota bears to the main track of the whole line. But on the allegations of the bill, which is all that we have before us, the circumstances are such as to make that mode of assessment indefensible. North Dakota is a State of plains, very different from the other states, and the cost of the roads there was much less than it was in mountainous regions that the roads had to traverse. The state is mainly agricultural. Its markets are outside its boundaries and most of the distributing centers from which it purchases also are outside. It naturally follows that the great and very valuable terminals of the roads are in other states. So looking only to the physical track the injustice of assuming the value to be evenly distributed according to main track mileage is plain."

In the recent case of *Rowley v. C. & N. W Ry. Co.*, 293 U. S. 102, 55 S. Ct. 55, the court said:

> "Where, as in this case, the evidence requires a finding that the railroad in one of the states reached by the system is clearly shown to be worth much less than the average value per mile of the system, an apportionment on mileage necessarily assigns an excessive amount to that state, and the use of that basis as the sole measure for apportionment must be condemned as arbitrary."

See also *Pittsburgh, C. C. & St. L. Ry. Co. v. Backus*, 154 U. S. 421; *Union Tank Line Co. v. Wright*, 249 U. S. 275; *Southern Ry. Co. v. Kentucky*, 274 U. S. 76.

These decisions did not hold that a mileage prorate was unlawful per se and in all cases. It might be proper where values are equal. It was held unlawful in these cases only because of the result—because the court was convinced as a fact

that in the particular case, property outside the state was being taxed.

Wallace v. Hines, supra, involved the petitioner in this case, and it involved the State of North Dakota. It arose upon demurrer to the complaint which the Court summarized as follows: "North Dakota is a state of plains, very different from the other states and the cost of the roads there was much less than it was in mountainous regions that the road had to traverse. The state is mainly agricultural. Its markets are outside its boundaries and most of the distributing centers from which it purchases also are outside. It naturally follows that the great and very valuable terminals of the roads are in other states. So looking only to the physical track, the injustice of assuming the value to be evenly distributed according to main track mileage is plain."

All of the facts referred to by the court in that case and a great many stronger facts have been proven here without contradiction so far as the inequality of track miles goes. That decision would be exactly in point here if it were not for the fact that North Dakota has now adopted a composite factor of allocation, averaging the track mileage ratio with other ratios showing miles of service.

It is true that this court sustained a somewhat similar composite factor in *Rowley v. C. & N. W. Ry. Co.,* 293 U. S. 102, 55 S. Ct. 55, but there there was no evidence that the traffic and service miles were of unequal value inside and outside the state. For all that appears in that case, a car mile, engine mile or ton mile inside Wyoming on the C. & N. W. Ry. Co. may have represented as much or more service as an average corresponding mile of service outside the state.

The facts in our case show an exceptional situation as to the service and traffic miles on the Great Northern Railway in North Dakota as well as the track miles.

To measure the property inside and outside North Dakota by using a mile of track as a measuring unit is to use a half sized measuring unit inside the state. It is mathematically demonstrable that it assesses property outside the state.

It is just as demonstrable that the state of North Dakota reaches the same result on the Great Northern Railway when it uses a mile of movement as a measure of service performed inside and outside the state. The company has to furnish twice as much fixed plant—more tunnels and bridges, heavier rail and grading and extensive terminals, and large repair shops in order to produce a mile of service outside the state. For this reason alone, a mile of movement is not an accurate measure by which to compare total service performed inside and outside the state. But in addition to furnishing more fixed plant, the company furnishes more auxiliary service outside the state, such as terminal service and repair work, for every mile of movement. The outside miles of movement represent a greater total volume of service, and to assume equality in and out of the state for the purpose of assessment, assesses outside property just as much as does the track mile ratio.

Run a train over the entire system and the engine mile ratio, car mile ratio, ton mile ratio and gross earnings ratio (on a mileage prorate) will all be identical for every state with the track mile ratio. The track mile ratio controls and fixes the others and they simply repeat the track mile ratio, with all its errors, under another name. Where a shipment uses only a part of the system, the ratio of miles of movement is identical with the track mile ratio for that part of the system and repeats its errors. It is true that miles of movement on parti-

cular parts of the system reflect varying volumes of service to some extent, but only in a misleading and inaccurate way, because the miles of movement in one state may be larger in number but smaller in total volume of service than in another. Witness the iron ore lines, where Minnesota has nine times as many miles of movement as Wisconsin, but only an equal total volume of service.

This is the situation in North Dakota on the Great Northern Railway. It may not exist on any other railroad and it may not exist in any other state. It was not shown to exist on the C. & N. W. Ry. in Wyoming in the Rowley case. But it is shown here without dispute that car and engine miles in North Dakota carry less traffic and perform less service; that all of the traffic miles require less fixed plant; and that they all involve less effort as measured by operating cost; and that miles operated in the large terminals outside the state were not counted.

If traffic miles, or a composite of traffic miles and track miles afford an infallible or even reliable ratio, in spite of such proof as we have offered here, it follows that on our iron ore carrying lines, the $16,000,000, 90 mile line in Minnesota is worth nine times as much as the $16,000,000, 10 mile plant in Wisconsin, merely because it is spread out more thinly over more miles. As a matter of fact, the ten miles in Wisconsin contain as much fixed plant and, including dock service, terminal switching, shop repairs, etc., they furnish as much total service as 90 miles in Minnesota. Wisconsin provides nine times as much plant and nine times as much service per mile. Either a track mile or a traffic mile in Wisconsin is equivalent to nine in Minnesota, and a mileage ratio, for assessment purposes would rob Wisconsin and credit Minnesota with several million dollars worth of property. The undisputed evidence here shows

that the same situation exists as between North Dakota and the balance of the Great Northern system. The distortion is not so grotesque, merely because it is spread over more miles, but the effect is the same.

In *Union Tank Line Co. v. Wright,* 249 U. S. 275, at 282-3, this court said:

> "But if the plan pursued is arbitrary and the consequent valuation grossly excessive it must be condemned because of conflict with the commerce clause or the Fourteenth Amendment or both. *Western Union Telegraph Co. v. Massachusetts,* 125 U. S. 530; *Marye v. Baltimore & Ohio R. R. Co.,* 127 U. S. 117; *Pullman's Palace Car Co. v. Pennsylvania,* 141 U. S. 18, 26; *Adams Express Co. v. Ohio,* 165 U. S. 194; s. c. 166 U. S. 185; *American Refrigerator Transit Co. v. Hall,* 174 U. S. 70; *Union Refrigerator Transit Co. v. Lynch,* 177 U. S. 149; *Fargo v. Hart,* 193 U. S. 490; *Cudahy Packing Co. v. Minnesota,* 246 U. S. 450, 453.
>
> In the present case the Comptroller General made no effort to assess according to real value or otherwise than upon the ratio which miles of railroad in Georgia over which the cars moved bore to total mileage so traversed in all states. Real values—the essential aim—of property within a state cannot be ascertained with even approximate accuracy by such process; the rule adopted has no necessary relation thereto. During a year two or three cars might pass over every mile of railroad in one state while hundreds constantly employed in another moved over lines of less total length. Fifty-seven was the average number of cars within Georgia during 1913 and each had a 'true' value of $830. Thus the total there subject to taxation amounted to $47,310—the challenged assessment specified $291,196.
>
> We think plaintiff in error's property was appraised according to an arbitrary method which produced results wholly unreasonable and that to permit enforcement of

the proposed tax would deprive it of property without due process of law and also unduly burden interstate commerce."

CONCLUSION.

We submit in conclusion that the Circuit Court of Appeals, in requiring us to negative the use of other methods, in addition to proving the use of the mileage prorates, was at variance with the principles established in *Pennsylvania Railroad Company v. Jacoby & Co.*, 242 U. S. 89, and that it overlooked the barrier against such negation established in *C. B. & Q. R. R. Co. v. Babcock*, 204 U. S. 585; and that it erred in failing to find from the pleadings and the undisputed evidence, that the Board of Equalization in fact gave controlling weight to the mileage prorates in allocating system value to the state, and that this necessarily resulted in assessing property outside the state, and was unlawful under the decisions in *Wallace v. Hines*, 253 U. S. 66, and similar cases.

And, irrespective of unlawfulness in the method of allocation, we submit that the Circuit Court of Appeals should have found an assessment of $78,832,888.00 to be arbitrary, where the value based on earnings and stock and bond prices for the three depression years preceding the assessment is only $23,937,317.00; where the state's own expert, by including boom year figures and allocating on mileage prorates, computes the value at only $63,307,629.00, by the method claimed by the state to be the best and most accurate; where he concedes that he has been unable to find any method by which a value equal to the assessment can be computed; and where the assessment is identical with that for 1932, which wholly ignored the shrunken earnings and reduced stock and bond prices of 1932 and 1933, and was based entirely on data for the year 1927 to 1931. We submit that under the decisions in *A. T. & S. F. Ry.*

Co. v. United States, the court should have found that the Board acted beyond the range of permitted discretion in assessing depression values at prosperity levels.

Respectfully submitted,

F. G. DORETY,
C. J. MURPHY,
Solicitors for Petitioner,
175 E. 4th St.,
St. Paul, Minn.

Dated at St. Paul,
Minnesota, June 17, 1935.